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EAST EUROPEAN REGIONAL ECONOMIC WRAPUP

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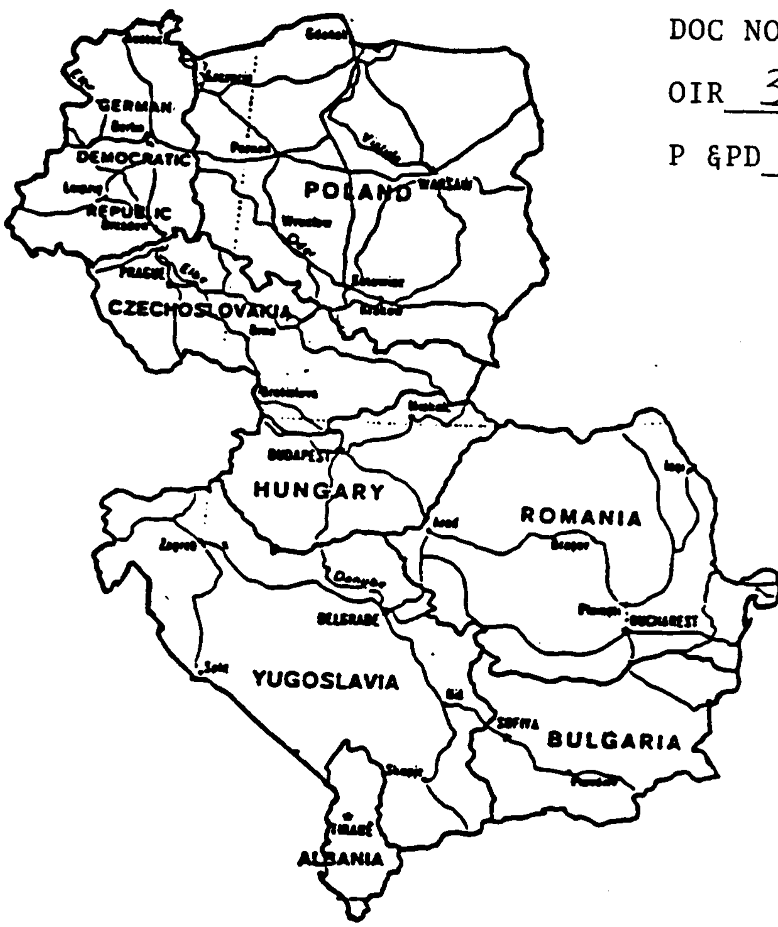

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This is a product of the Regional East-West Economics Branch, East European Division, Office of European Analysis. The report was prepared by [redacted] Any comments or suggestions should be directed to [redacted] Chief, East European Division, Office of European Analysis, at [redacted]

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EAST EUROPEAN REGIONAL ECONOMIC WRAPUP

Synopsis of this Issue

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Economies Still Struggling in 1986

Recently released data suggest Eastern Europe's economic performance in the first quarter of 1986 weakened even compared to last year's poor showing. [redacted] 25X1

The hard currency deficit for the region -- excluding Romania and East Germany, for which no data are available -- was an estimated $900 million, compared with a slight surplus in the first quarter of 1985. Increases in imports, especially from the Developed West, outstripped export growth. [redacted] 25X1

The deterioration in trade was particularly significant for Hungary, Bulgaria, and Czechoslovakia. Officials in several countries have expressed disappointment with the trade figures, especially because economic plans had stressed generating larger hard currency trade surpluses than in the past. Further poor trade results may make bankers more cautious in lending to some countries. [redacted] 25X1

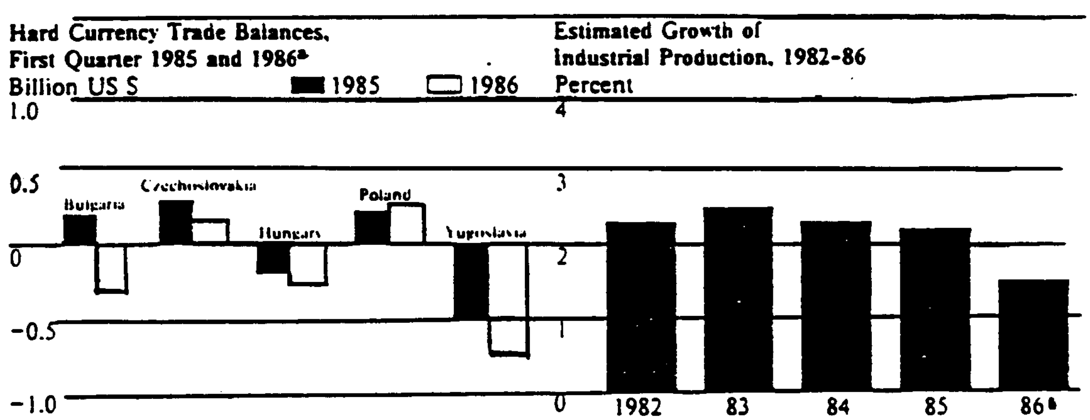
[redacted] 25X1

Data on first-quarter industrial growth, when adjusted for the effects of last year's unusually severe winter, show a decline below the annual rate in 1985. Encouraged by a relatively moderate winter this year, East European regimes hoped for stronger showings as they began new five-year plans. Bulgaria has admitted that its growth rates are deceptively high because output is compared with a poor 1985 showing and exaggerates the true level of economic growth. Prague's criticism of inertia in the Czechoslovak economy has been unusually harsh, and a Hungarian economist recently told a US diplomat that Hungary's GNP might not increase at all in 1986. Poland's industrial growth has tapered off in recent months from the fast first-quarter start. Preliminary data for East Germany indicates relatively stronger growth than in 1985. [redacted] 25X1

Prospects for most of these economies over the rest of the year are not bright. Declining oil prices in the West have cut earnings from the region's refined petroleum products and reduced the ability of Third World oil producers to buy goods from Eastern Europe. Tourism and food exports to Western Europe have also suffered since the Chernobyl' accident. [redacted] 25X1

The slow industrial growth and the decline in hard currency trade performance for most of the countries suggest that the region's recovery from the economic stagnation and financial problems of the early 1980s is running out of steam. With the Soviets pushing Eastern Europe to increase economic growth and poor 1986 results already apparently throwing some of the new five-year plans off schedule, East European leaders will come under increasing pressure to take stronger actions to address economic problems. [redacted] 25X1

Eastern Europe: Selected Economic Indicators



a Data for East Germany and Romania are not available

b Data for first quarter results adjusted to remove distortions of the winter of 1985

[redacted] 25X1

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Hard Currency Debt Reaches Record High

Eastern Europe's gross hard currency debt rose to a record $87.4 billion at yearend 1985, reversing the recent pattern of generally falling debt (see Annex). Net debt rose by only $5 billion as several countries built up their foreign exchange reserves. We estimate that most of the increase over 1984 was due to the falling value of the dollar against other Western currencies, which increases the dollar value of debt borrowed in these currencies. The rise in debt attributable to the falling dollar is largely a statistical effect and does not necessarily reflect a weaker financial position. Nonetheless, new lending by commercial banks also added to the region's obligations and was the principal force behind the substantial growth of Bulgaria's and Hungary's debts. Much of the increase in the region's reserves was funded by borrowing as several countries took advantage of low interest rates and longer maturities on loans to build a cushion against any future cutback in lending to the region.

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Falling interest rates and the reduction of net debt in 1982-84 lowered the East Europeans' debt service ratios from the levels in the early 1980s. However, all countries except Bulgaria and Czechoslovakia still devote more than 30 percent of hard currency earnings to debt service, indicating the region's continued financial vulnerability.

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Key developments:

- Poland remained the region's most heavily indebted country, owing $29.3 billion to the West. The 10-percent increase in its debt reflected almost entirely the impact of the falling dollar.
- Yugoslavia's debt fell slightly to $18.8 billion but would have fallen more without the dollar devaluation.
- East Germany's gross debt shot up to nearly $14 billion, yet net debt fell as East Berlin increased its reserves by $2 billion to a record $6.5 billion.
- Hungary's and Bulgaria's gross debts grew most rapidly, to $11.8 billion and $3.2 billion, respectively, as they stepped up borrowing to build reserves and cover severe shortfalls in hard currency trade.
- Only Romania reduced its debt significantly -- by $500 million to $6.6 billion -- as the Ceausescu regime held to its policy of squeezing the domestic economy to eliminate external debt.

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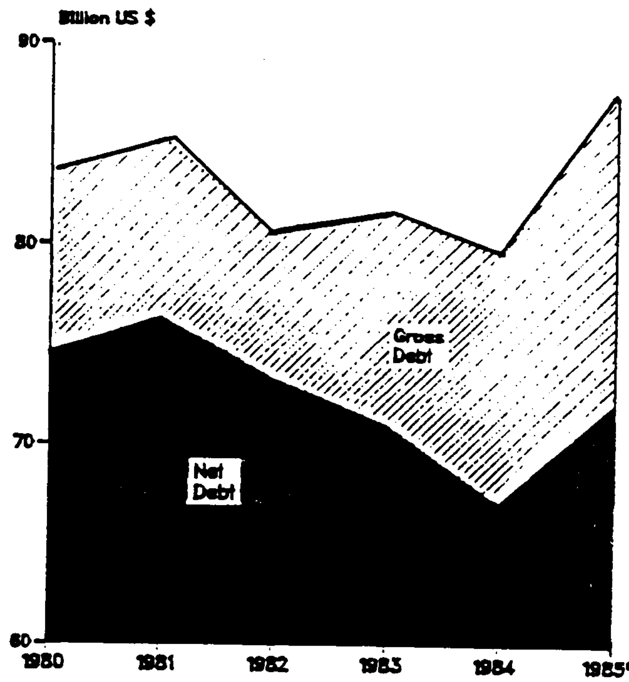
Eastern Europe: Gross And Net Hard Currency Debt, 1980-85



a Preliminary data

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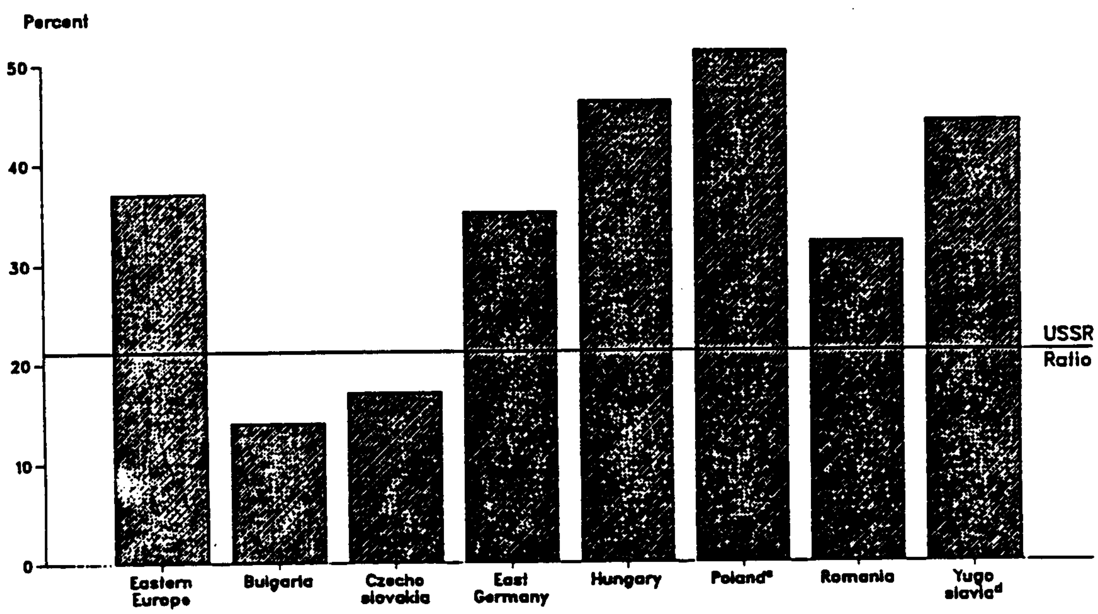
The rise in the region's indebtedness has not deterred creditors from extending new loans to some East European countries this year or refinancing some older loans on better terms. Hungary and Czechoslovakia obtained sizeable syndicated loans this spring, and bankers remain particularly eager to lend to East Germany. Some bankers are beginning to balk at the low interest rates sought by the East Europeans, but at least for the present other bankers appear willing to close any gap. 25X1

On the other hand, Poland, Yugoslavia, and Romania -- unable to receive new loans and facing payments difficulties -- have already had to seek relief from creditors this year. Yugoslavia has rescheduled principal, and Romania has tentatively reached agreement with commercial creditors on rescheduling some $880 million in principal payments falling due in 1986-87. Poland, claiming an inability to make required payments, recently requested the reopening of the 1986 Paris Club agreement. 25X1

Eastern Europe: Debt Service Ratios[a], 1985[b]



a Debt Service Ratio = (Interest Payments + Medium and Long Term Principal Repayments)/ (Total Exports + Invisible Receipts)
b Preliminary data
c Based on payments made, not owed
d Excludes principal repayments rescheduled in 1983-85

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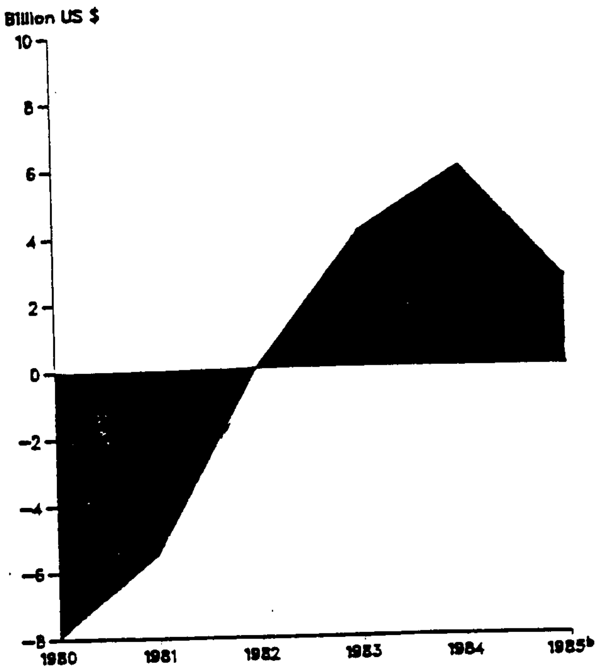
Eastern Europe: Hard Currency Current Account Balances[a], 1980–85



a Figures for Poland based on interest paid rather than interest due
b Preliminary data

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Current Account Surplus Plunges

The region's surplus in its hard currency current account -- exports of goods and services minus imports of goods and services -- sank last year to $2.6 billion, less than half that recorded in 1984, reversing the six-year trend of improving current account balances. 25X1

- o Hungary slumped into a $450 million deficit, and Bulgaria barely avoided a deficit.
- o Yugoslavia's surplus fell by more than half to $340 million.
- o The surpluses of financially-strapped Poland and Romania plunged 60 and 40 percent to $320 million and $900 million, respectively. 25X1
- o Romania's surplus of $900 million and East Germany's balance of $850 million were the largest in the region. 25X1

The region's $3.7-billion fall in its hard currency trade surplus in 1985 was the major factor behind the deterioration of the current account balance. Exports fell 3 percent because of the cold winter and severe drought -- which disrupted industrial and agricultural production -- and soft agricultural prices. At the same time, imports rose 5 percent to meet needs for energy, grain, and capital goods. Poor trade performance so far this year has dampened the hope for any significant improvement in 1986 balances and complicated debt servicing by Romania, Poland, and Yugoslavia. Bankers are becoming increasingly wary about lending to Hungary, which borrowed heavily in 1985 and whose current account remained in deficit in the first half of this year. Without a turnaround in its current account results, Bulgaria could also face a loss in creditor confidence. 25X1

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Falling Oil Prices Yield Little Benefit to CEMA Countries

The decline in world oil prices has not helped most East European countries because the region imports more than three-quarters of its oil from the USSR. Only Yugoslavia -- which is not a member of CEMA -- has negotiated a reduction of oil prices, which will save Belgrade at least $500 million this year on purchases from both the USSR and other oil-exporting countries. 25X1

The price currently paid by CEMA countries (except Romania) to the USSR for crude oil -- $30 per barrel at the official ruble-dollar exchange rate -- was about double the world price in May 1986. Most of the countries pay for Soviet oil based on a price formula which averages the world crude oil price for the previous five years. This formula benefited Eastern Europe in the 1970s when oil prices rose rapidly but now is disadvantageous due to falling world prices and eliminates earlier Soviet subsidies to the region. Although the price difference may tempt some countries to buy oil from non-Soviet sources, such a shift is unlikely because Eastern Europe can pay the USSR with low-quality goods rather than scarce hard currency that would be required for purchases in world markets.

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The sharp fall in world oil prices has also reduced hard currency earnings for the East European CEMA states:

- o Soft world prices have cut the value of Eastern Europe's exports of refined oil products and petrochemicals. We project that Eastern Europe's revenues on sales of petroleum products to the Developed West in 1986 will be about $1.4 billion lower than last year due to falling world oil prices. 25X1

- o East European countries can no longer earn large profits on the reexport of Middle Eastern or Soviet crude oil. A Hungarian economist told US diplomats that the market prices at which Budapest was reexporting refined Soviet crude has dipped as low as $12 per barrel.

- o Middle Eastern oil-producing countries are buying fewer goods, arms, and construction services from Eastern Europe due to reduced oil revenues. 25X1

Eastern Europe should gradually obtain relief from high Soviet oil prices under the CEMA pricing formula. Next year Soviet crude oil prices will fall by 13 percent, and if OPEC prices remain $15 per barrel through 1990, prices could fall further by 15 percent per year. Because oil imports comprise a large share of its purchases from the USSR, Eastern Europe should begin running large trade surpluses with the Soviets unless Moscow forces offsetting reductions in the region's export prices. Current price trends, together with planned increases in export volume to the USSR, should enable Eastern Europe to pay off its ruble debt to Moscow before 1990.

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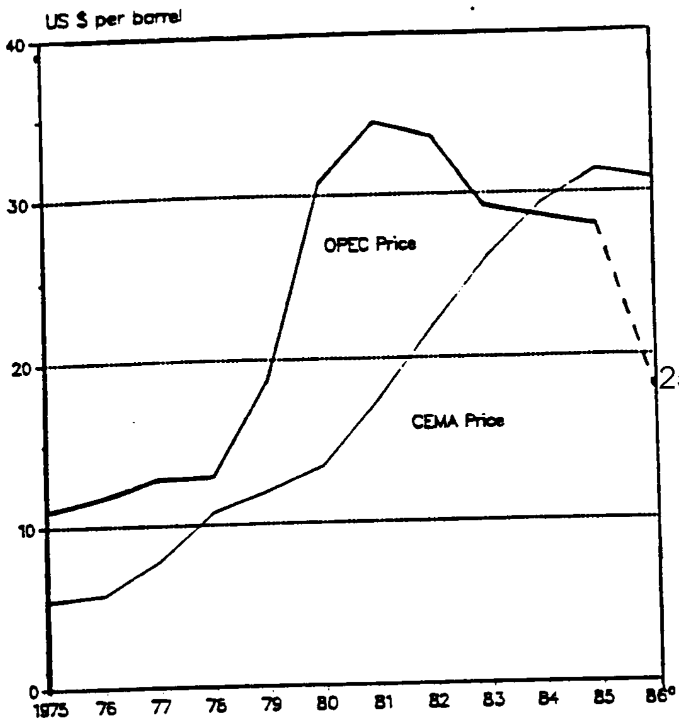
Eastern Europe: Crude Oil Prices, 1975–86



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a Preliminary estimate for OPEC price. Market developments during 1986 could alter this estimate by several dollars in either direction. The 1986 CEMA price is based on OPEC prices in 1981–85.

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Chernobyl' Accident Imposes Immediate Costs

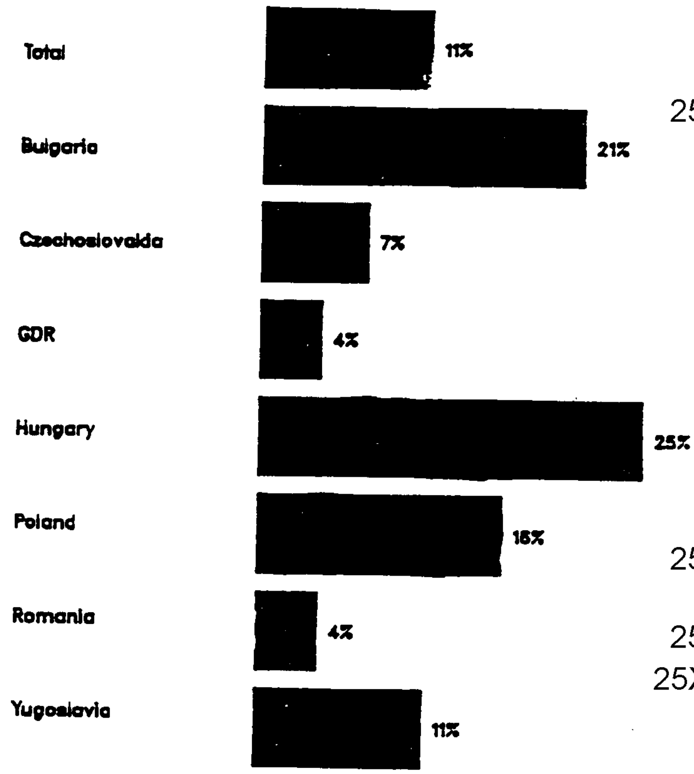
We estimate that East European agricultural export losses as a result of the Chernobyl' nuclear disaster may mount to $600 million in 1986 -- about 3 percent of the region's sales to the Developed West. The European Community's now expired ban on imports of food products and livestock from these countries (except East Germany), similar restrictions by other countries, and lingering consumer fears will continue to limit agricultural sales. The losses will hit hardest at Poland, Hungary, Yugoslavia, and Bulgaria, which depend the most on agricultural exports. [redacted] 25X1

The countries in the region have incurred other costs:

- Hungary, Poland, Bulgaria, and Yugoslavia have all cited cancellations in tourist bookings;
- Western inspections of shipments from Eastern Europe have caused delays and transport losses;
- The ban on grazing has increased grain consumption and possibly import requirements;
- Some consumer supplies, particularly dairy products, have been reduced;
- Government and consumer expenditures on health products, services, and medicines to counteract contamination and equipment to monitor radiation have risen by unspecified amounts. [redacted] 25X1

Some East European countries have tried to recover some of their losses by pressing for compensation from the USSR. [redacted] 25X1 [redacted] 25X1 the USSR agreed to buy surpluses of meat and vegetables which could not be sold in Western Europe. The US Embassy in Budapest also reported a Soviet promise to purchase all unsold Hungarian meat for as much as $75 million in hard currency. Chernobyl' -- and possibly compensation -- may have been topics of discussion at an unprecendented separate meeting of party leaders following the recent regular session of the Warsaw Pact's Political Consultative Commission in Budapest. Moscow may make token gestures of compensation, but its own financial problems should preclude giving significant restitution. Some countries may use the costs imposed on them by the accident as an excuse for not meeting their economic commitments to the USSR. [redacted] 25X1

Eastern Europe: Food Products As A Share Of Exports To The Developed West, 1984



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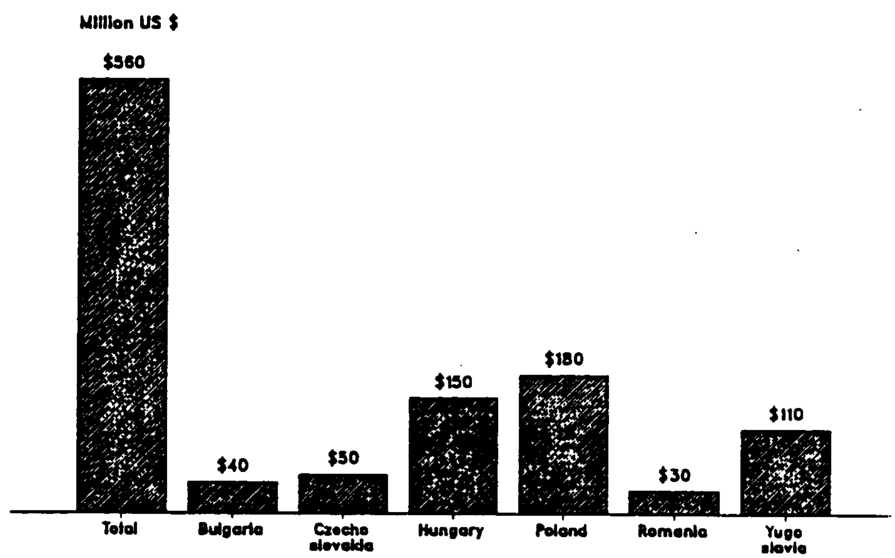
Eastern Europe[a]: Projected Drop In Hard Currency Trade Balances, 1986[b,c]



a Excluding the GDR, which generally has been exempt from the bans. West Germany has guaranteed that East German goods transiting West Germany to EC markets meet West German health standards

b Based on preliminary 1986 data

c Assuming each country loses one quarter of its food exports to the Developed West, with no other changes in trade

[redacted] 25X1

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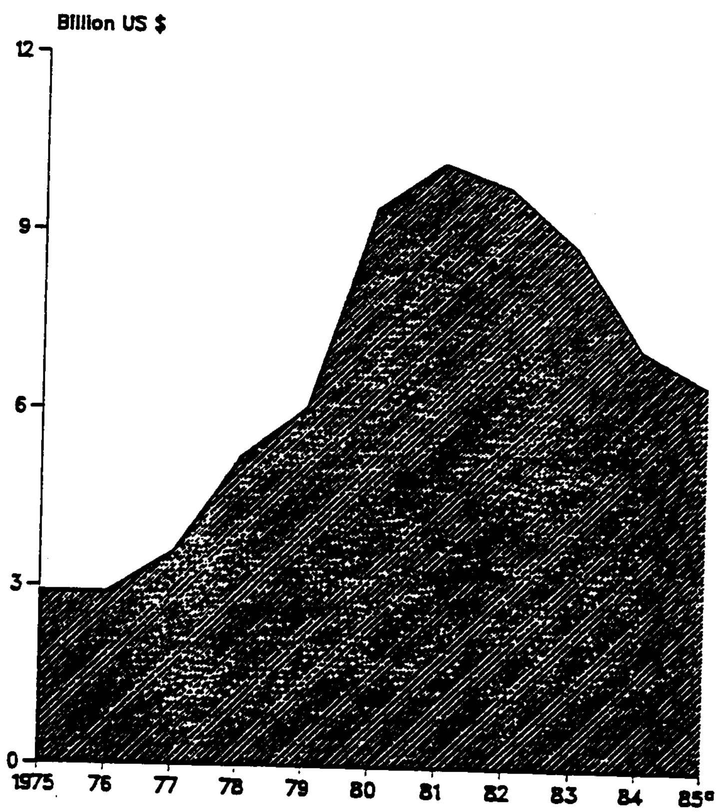
Featured Country:
Romanian Financial Strategy Faltering

Romania's plan for financial recovery continues to falter, following weak hard currency trade performance in 1985 and the first quarter of this year. By the end of April, Bucharest had either rolled over on a short-term basis or missed nearly $300 million in payments due to Western creditors. Romania also requested in May a rescheduling of payments due this year on commercial debt previously rescheduled in 1982. 25X1

President Ceausescu's strategy of suppressing imports and imposing painful austerity has succeeded in producing hard currency trade surpluses and reducing Bucharest's debt. However, the economy has been drained of resources and is unlikely to produce enough export goods to improve last year's hard currency trade surplus of $1.4 billion -- down from $2.2 billion in 1984. 25X1

Despite a tentative agreement with commercial creditors to reschedule $880 million due this year and next on debt previously rescheduled in 1982-83, Romania still faces a financing gap of $200 million this year. Bucharest is likely to persist in suppressing imports and pushing for large export gains and may well continue to request only small amounts of debt relief, an approach that would not ease the strain on the economy. The result is likely to be continued economic stagnation and grinding austerity. 25X1

Romania: Gross Hard Currency Debt, 1975–85



a Preliminary data

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Five-Year Plans Focus on Modernization

The new five-year plans for Eastern Europe are generally similar in calling for modest economic growth, major investment programs to modernize selected industries, and increases in net exports. The plan goals are intended to narrow the technological gap with the West, improve energy efficiency, and promote export competitiveness. As usual, industry receives emphasis over agriculture as the leading source of growth. Within industry, machine tools, high technology industries, and energy conservation programs claim top priority, and the traditional heavy smokestack industries will be downgraded in importance. Countries in the Northern Tier and Hungary are also increasing expenditures on environmental protection. Finally, the growth of consumption will be limited.

The new plans attempt to address Soviet demands for better economic performance by incorporating most of Gorbachev's nostrums for growth -- discipline, emphasis on machine-building, promotion of science and technology, and closer CEMA integration. Soviet complaints about the poor quality of East European exports have encouraged the region's planners to increase investments in industries that serve as major suppliers to the USSR. Overall the countries are to run trade surpluses with the USSR to repay trade debts incurred over the past decade. The Bloc's long-term science and technology agreement -- the CEMA 2000 program -- could place substantial demands on Eastern Europe's research capabilities. Despite the Chernobyl' accident, most East European CEMA members plan by 1990 to at least double nuclear power generation over 1985 levels, and the CEMA 2000 program calls for further growth in the next decade (see Map). Nonetheless, the accident has already caused some countries to improve safety which boosts the cost of this energy source.

To achieve the goals for economic growth, the East European countries must use material inputs more efficiently than in the past because raw materials are slated to grow more slowly than finished goods. The targets are to be achieved almost entirely through increased labor productivity, as demographic trends will limit expansion in the work force. Eastern Europe's lackluster performance in absorbing Western machinery in the 1970s suggests the plans may again overestimate the potential for high technologies to accelerate growth, improve export competitiveness, and boost labor productivity. Finally, tighter links with CEMA may also limit Eastern Europe's opportunities to benefit from technological exchange with the West.

Eastern Europe: Target Growth Rates, 1986-90

(Figures show percentage growth of planned 1990 levels over those for 1985, unless otherwise noted)

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Country	National Income Produced	Industry	Agriculture
Albania	34-36	29-31	34-36
Bulgaria	22-25	25-30	6-8*
Czechoslovakia	18-19	15-18	6-7*
GDR	24-26	22-24	NA
Hungary	15-17	14-16	7-10*
Poland	16-19	16**	5-6*
Romania***	60-65	43-49	35-38*
Yugoslavia	22	25	28

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* Planned total for 1986-90 over output for 1981-85.

** Socialized industry only.

*** Figures show planned growth over 1985 plan goals.

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Nuclear Reactors in Eastern Europe

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Eastern Europe: Hard Currency Debt, 1984 and 1985a
(Million US $)

	1984	1985
Eastern Europe		
Gross Debt	79570	87420
Commercial	41110	46155
Official	30620	33175
IMF/World Bank/Other	7840	8090
Reserves	12500	15370
Net Debt	67070	72050
Bulgaria		
Gross Debt	2260	3170
Commercial	1770	2620
Official	490	550
Reserves	1430	2090
Net Debt	830	1080
Czechoslovakia		
Gross Debt	3600	3850
Commercial	2565	2855
Official	1035	995
Reserves	1010	1010
Net Debt	2590	2840
East Germany		
Gross Debt	12150	13950
Commercial	8050	10050
Official	4100	3900
Reserves	4540	6490
Net Debt	7610	7460
Hungary		
Gross Debt	8840	11760
Commercial	6940	9760
Official	760	830
BIS/IMF	1140	1170
Reserves	2100	2900
Net Debt	6740	8860
Poland		
Gross Debt	26800	29300
Commercial	9400	10600
Official	17400	18700
Reserves	1550	1590
Net Debt	25250	27710

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Romania		
Gross Debt	7100	6600
Commercial	3430	2770
Official	1070	1100
IMF/World Bank/CEMA Banks	2600	2730
Reserves	710	200
Net Debt	6390	6400
Yugoslavia		
Gross Debt	18820	18790
Commercial	8955	7500
Official	5765	7100
IMF/World Bank	4100	4190
Reserves	1160	1090
Net Debt	17660	17700

a Preliminary data

SUBJECT: East European Regional Wrapup

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